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ABSTRACT

Information on basic trends in state and local government finances is presented in this fact sheet, which presents data on aggregate state and local government revenues, expenditures, and related variables for the period 1961-90. Data were derived from the Department of Commerce's National Income and Products Accounts to describe aggregate state-local trends and to contrast those with federal level trends. Data from the Bureau of Census and the Office of Management and Budget provide more detailed breakdowns of state and local revenues and expenditures. Trend data are presented in a graphic format accompanied by brief narrative descriptions. Individual sections present information on the following: the fiscal condition of the state-local sector; federal and state-local financing of domestic expenditures; state-local expenditures; state-local intergovernmental revenues; state-local own-source revenues; and recent experiences of state-local finances. Findings indicate that the state-local sector is experiencing record high tax burdens and deficits in financing current service operations and increased responsibility for financing domestic expenditures. With regard to revenue, state-local revenues from the federal government have decreased and revenues from personal income, general sales, and property taxes have increased. Five tables and 30 figures are included. Contributors to the report are listed in the appendix. (LMI)

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United States General Accounting Office

GAO

Fact Sheet for the Majority Leader, House of Representatives

March 1992

INTERGOVERNMENTAL RELATIONS

Changing Patterns in State-Local Finances

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United States
General Accounting Office
Washington, D.C. 20548

Human Resources Division

B-247926

March 31, 1992

The Honorable Richard A. Gephardt
Majority Leader
House of Representatives

Dear Mr. Gephardt:

This fact sheet responds to your request for information on the fiscal problems of state and local governments. After consultation with your staff, we agreed to provide a fact sheet that describes basic trends in state and local government finances. Subsequent reports will analyze these trends and discuss their policy implications.

This fact sheet presents data on aggregate state and local government revenues, expenditures, and related variables over the 30-year period from 1961 to 1990. This time span starts before the growth in federal aid to state and local governments that began in the 1960s, which allows for the more recent policy changes of the 1980s to be put in perspective.

We used data from the Department of Commerce's National Income and Product Accounts to describe aggregate state-local trends and to contrast these with trends at the federal level. Data from the Bureau of the Census and the Office of Management and Budget were used to provide more detailed breakdowns of state and local revenues and expenditures. However, all data are reported in the aggregate and, therefore, do not reveal regional deviations from the trends reported here. Dollar amounts are generally expressed in real 1982 dollars to control for the effects of inflation.

To facilitate interpretation of the information, the trend data are presented in a graphic format accompanied by brief narrative descriptions.

Major trends that we found were:

- The state-local sector is running a deficit in financing its current service operations. This deficit is approaching a record high for the 30-year period.
- Deficits have been growing because expenditures have risen even faster than revenues. However, state-local tax burdens continue to rise and have reached a 30-year high.

On the expenditure side we found:

- State and local governments have taken on an increasing share of the responsibility for financing this country's domestic expenditures. While both the federal and state-local governments continue to share the financing of "safety-net" programs like Medicaid, state-local governments have assumed a greater portion of the burden for other types of public consumption and investment.
- Health care spending is the most rapidly growing area in state-local budgets. Real levels of spending for cash assistance and capital investment have been virtually flat over the past three decades.

On the revenue side we found:

- The growth in intergovernmental revenues received by state-local governments from the federal government leveled off in the late 1970s, after adjusting for inflation, and such revenues have declined as a percentage of both gross national product and state-local revenues.
- Since the late 1970s, intergovernmental revenues have shifted toward Medicaid and away from most other areas, especially investments in transportation, job training, and community and regional development.
- Revenues from personal income and general sales taxes have been the most rapidly growing state-local own-source revenues. Revenues from the more narrowly based corporate income and excise taxes (gasoline, alcohol, tobacco, etc.) have increased the least.
- Although local property tax revenues declined in the late 1970s, they have resumed the steady upward rise experienced during the 1960s.

Unless you publicly announce its contents earlier, we plan no further distribution of this fact sheet until 30 days from its issue date. At that time, we will send copies of this fact sheet to selected congressional committees and subcommittees and make it available to others on request.

This fact sheet was prepared under the direction of Gregory J. McDonald, Director, Human Services Policy and Management Issues, who may be reached at (202) 512-7225 if you or your staff have any questions. Other major contributors are listed in appendix I.

Sincerely yours,

Lawrence H. Thompson

Lawrence H. Thompson
Assistant Comptroller General

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Abbreviations

AFDC	Aid to Families with Dependent Children
GRS	General Revenue Sharing
GNP	Gross National Product
NIPA	National Income and Product Accounts
OMB	Office of Management and Budget
OBRA	Omnibus Budget Reconciliation Act of 1981
SSI	Supplemental Security Income

The Fiscal Condition of the State-Local Sector

The surplus or deficit of the state-local sector is an indicator of the overall fiscal condition of those governments.[1] This section presents trend data on aggregate receipts, expenditures, and resulting surpluses or deficits for the sector. Following sections will provide additional detail on state-local revenues and expenditures.

The data used in this section are from the National Income and Product Accounts (NIPA) published by the Bureau of Economic Analysis, U.S. Department of Commerce. Table 1.1 defines the key terms used in this section.

[1]Throughout this fact sheet, "state-local" refers to the 50 states and all local governments, including municipalities, counties, townships, school districts, and special districts.

Table 1.1: Definitions of Key Terms

Term	Definition
State and local total receipts	Includes personal tax and nontax receipts (e.g., income taxes); corporate profits taxes; indirect business taxes, such as sales and property taxes; contributions for social insurance, such as temporary disability insurance; and federal grants-in-aid.
State and local total expenditures	Includes purchases of goods and services (including compensation of state and local government employees), transfer payments to persons, net interest paid, and net subsidies of government enterprises.
State and local surplus/deficit:	
Total	Total receipts minus total expenditures.
Excluding social insurance funds	Total surplus or deficit minus the net income (contributions received and interest and dividends earned minus payments and associated administrative expenses) of social insurance funds, including state and local employee retirement, temporary disability, and workers' compensation funds.
Gross national product (GNP)	Market value of the goods and services produced by labor and property supplied by residents of the United States.

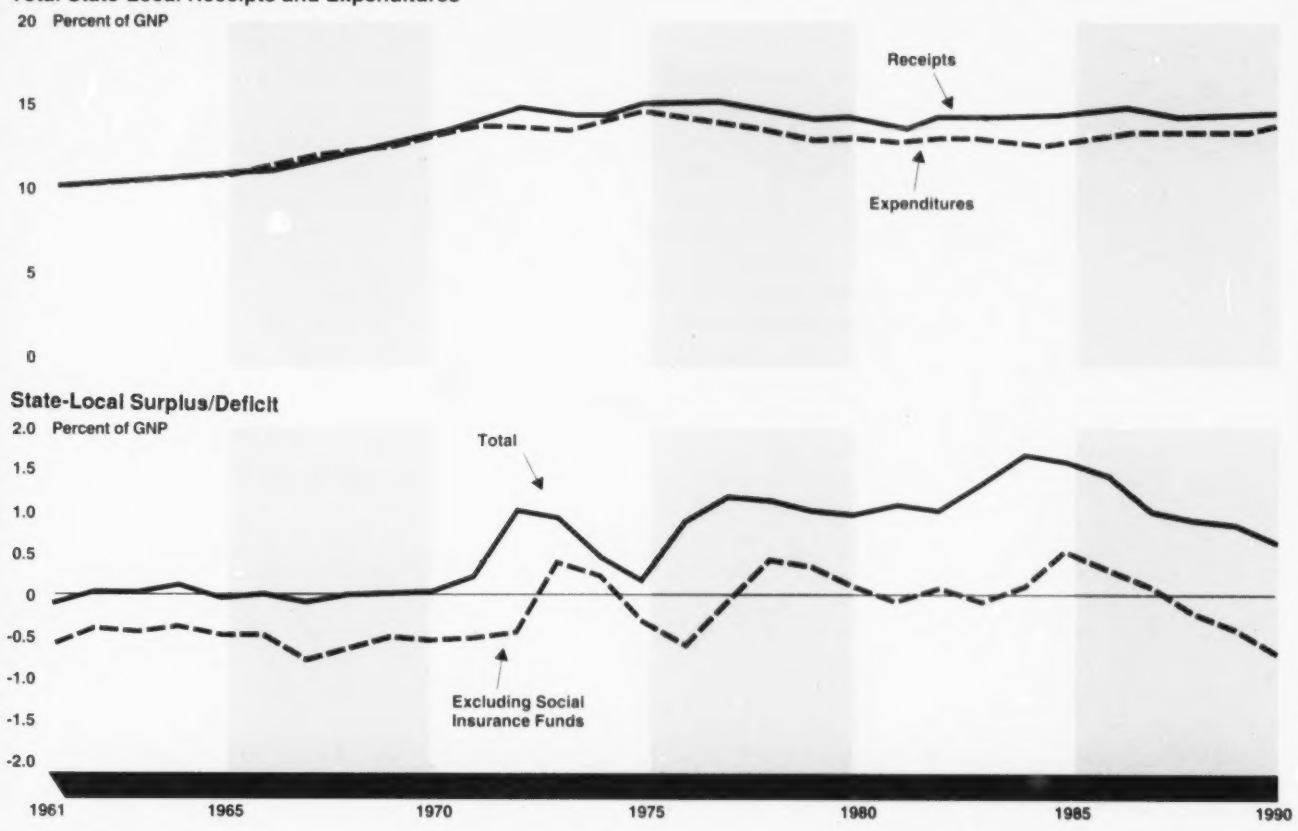
Source: U.S. Department of Commerce, Bureau of Economic Analysis, NIPA.

State-Local General Deficit Largest in 15 Years

Until the early 1970s, total state-local receipts and expenditures were about equal, resulting in annual surpluses or deficits near zero. Between the early 1970s and mid-1980s, except for a downturn corresponding to the 1973-1975 recession, total receipts ran ahead of total expenditures, creating an aggregate surplus. Since 1984, however (even before the current recession was felt), this surplus declined consistently relative to the growing economy.

Excluding the net income of social insurance funds from the total surplus provides a better indicator of state and local government financing of current services. Excluding social insurance funds (the largest of which are employee-retirement funds), aggregate state-local finances have been in deficit most years. Since 1984, the deficit as a percentage of GNP has increased to levels prevailing in the 1960s and last seen during the recession in 1975. (See fig. 1.1.)

Figure 1.1: Summary Measures of State-Local Finances



Federal and State-Local Financing of Domestic Expenditures

This country's domestic programs are implemented through a complex partnership among federal, state, and local governments. This section deals with the relative roles of the federal and state-local sectors in financing these programs.

As in section 1, we use the National Income and Product Accounts data in this section because they allow a consistent comparison between federal and state-local finances. However, because this section focuses on current domestic spending, we have made some adjustments to NIPA data. Federal expenditures exclude spending on national defense and net interest paid on the national debt.[1] State and local expenditures also exclude net interest payments. Where state-local expenditures are compared with federal domestic expenditures (see figs. 2.1 and 2.2), they also exclude spending financed by grants-in-aid from the federal government to avoid double-counting. We refer to this measure of state-local expenditures as state-local expenditures financed from own sources. However, in figures 2.3 and 2.4, which show the composition of state-local expenditures, expenditures out of grants-in-aid are included in state-local expenditures. We refer to this measure of state-local expenditures as current services expenditures.

Table 2.1 defines the key terms used in this section.

[1]Federal deposit insurance expenditures are not reflected in our measure of federal expenditures because they represent exchanges of assets and, accordingly, are not included in NIPA. Federal deposit insurance budget expenditures rose from about $10 billion in 1988 to $58 billion in 1990.

Table 2.1: Definitions of Key Terms

Term	Definition
Federal domestic expenditures	Includes nondefense purchases of goods and services, transfer payments to individuals, grants-in-aid to state and local governments, and net subsidies of government enterprises. Excludes purchases of goods and services for national defense and net interest payments.
State-local expenditures financed from own sources	Includes purchases of goods and services, transfer payments to individuals, and net subsidies of government enterprises—less grants-in-aid received from the federal government. Excludes net interest payments.
State-local current services expenditures	Total state and local expenditures, excluding net interest payments.
Purchases of goods and services	Compensation of government employees and purchases from businesses and from abroad.
Grants-in-aid	Net payments from the federal government to state and local governments to help finance state and local government activities in such areas as public assistance, highway construction, and education.
Federal transfers	Benefits paid to individuals from social insurance funds (Social Security, Medicare, unemployment insurance, federal employee retirement, railroad retirement, veterans' life insurance, workers' compensation); veterans' benefits; food stamps; black lung benefits; Supplemental Security Income (SSI); and earned income credit.
State-local transfers	Benefits from social insurance funds (state and local employee retirement, temporary disability, and workers' compensation); public assistance (medical care, Aid to Families with Dependent Children (AFDC), SSI, general assistance, and energy assistance); education; and employment and training.

Source: Based on NIPA.

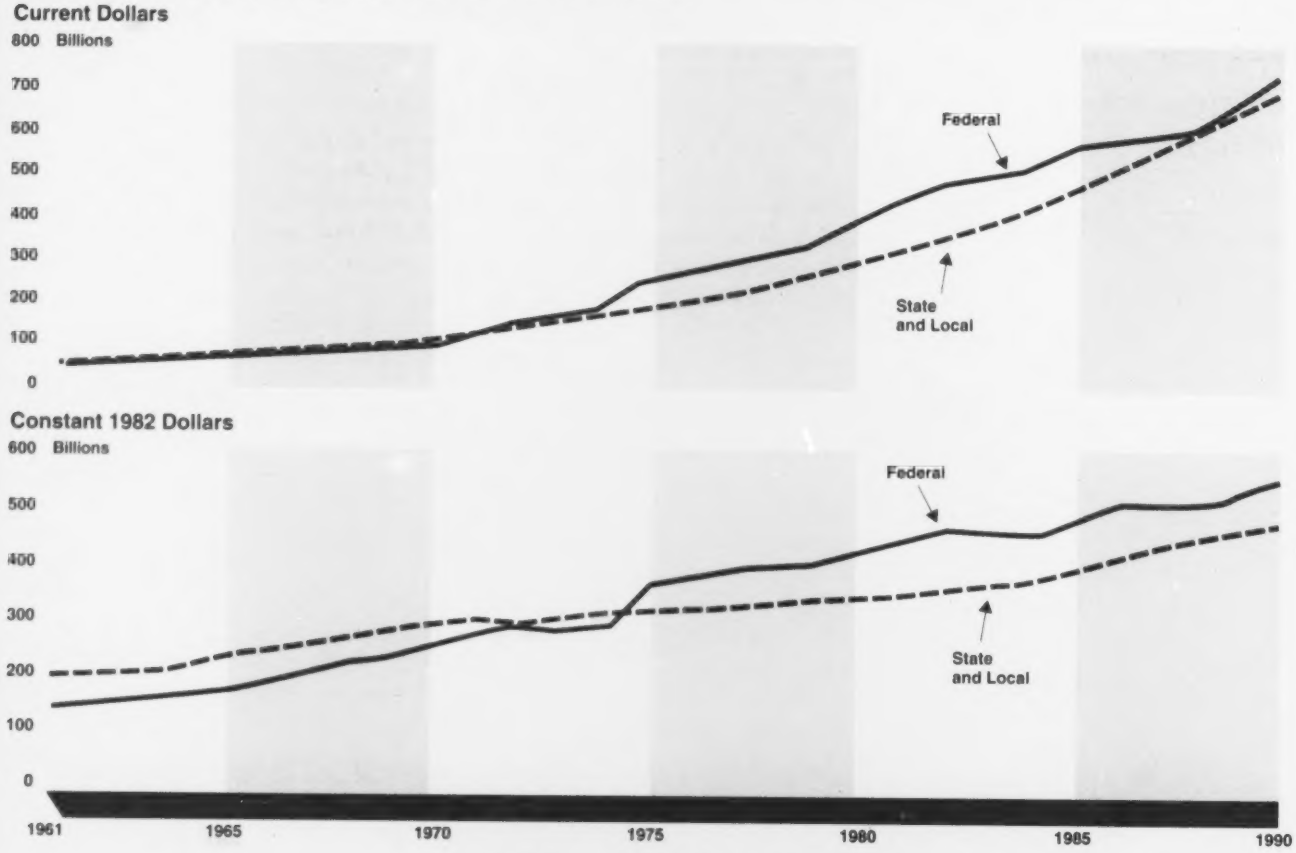
Growth in State-Local Spending Has Been Steadier Than Federal Domestic Spending Growth

Both federal and state-local spending on domestic programs have grown in nominal (current) as well as real (inflation-adjusted) dollars over the last three decades. However, the growth in state-local expenditures has been more consistent than the domestic spending growth of the federal government. (See fig. 2.1.)

In the 1960s and early 1970s, nominal federal and state-local domestic expenditures grew at about the same rates. From the mid-1970s through 1982, however, federal domestic spending accelerated, surpassing state and local spending in real terms in 1975. During the same period, state and local real expenditures continued to increase, but at a slower rate compared with the 1960s.

Federal domestic spending declined in real dollars twice during the 1980s: from 1982 to 1984 and again between 1986 and 1988. During this period, state-local spending accelerated, thus narrowing the gap with federal domestic expenditures.

Figure 2.1: Domestic Expenditures, In Current and Constant Dollars



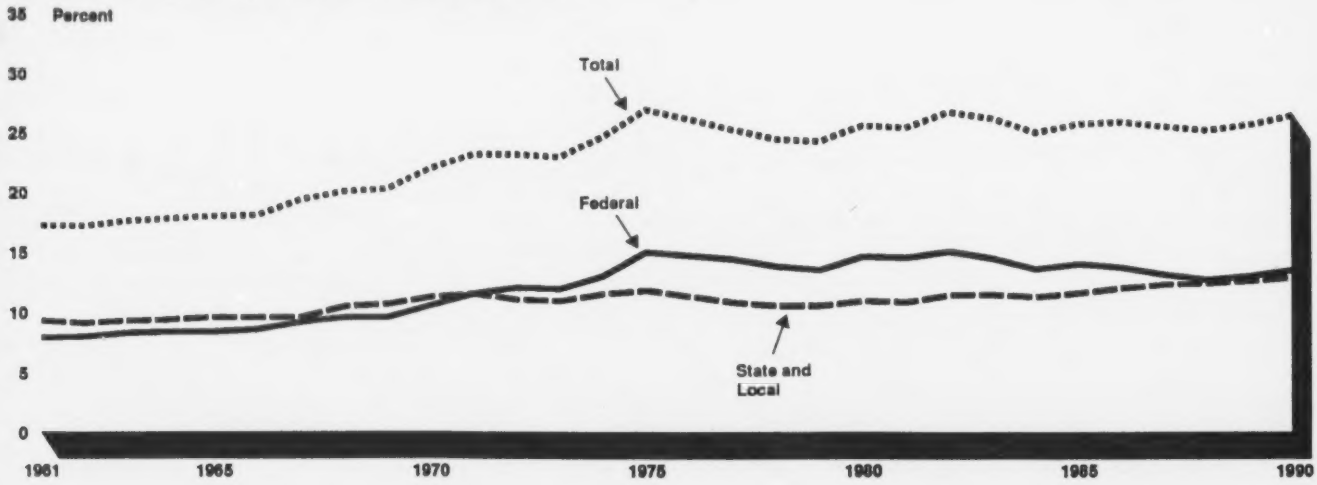
Note: State and local expenditures are expenditures financed from own sources, i.e., they exclude spending from federal grants-in-aid.

Federal and State-Local Domestic Spending Has Been Flat Relative to the Economy Since the Mid-1970s but the State-Local Share Has Increased

Total domestic spending increased its representation in gross national product throughout the 1960s and early 1970s. Since 1975, however, domestic spending has remained relatively constant, making up about one-fourth of the economy.

Even while total spending has been constant as a percentage of GNP, the relative shares of the federal and state-local governments in domestic spending have varied. From 1961 to 1971, state and local governments financed a larger portion of domestic expenditures than the federal government. Beginning in the late 1960s, federal spending accelerated, surpassing state-local spending in 1971 and remaining substantially above it until the early 1980s. Between 1982 and 1988, federal spending slowed, while state and local spending increased. From 1988 on, each sector financed a near-equal portion of total domestic expenditures. (See fig. 2.2.)

Figure 2.2: Domestic Expenditures as a Percent of GNP



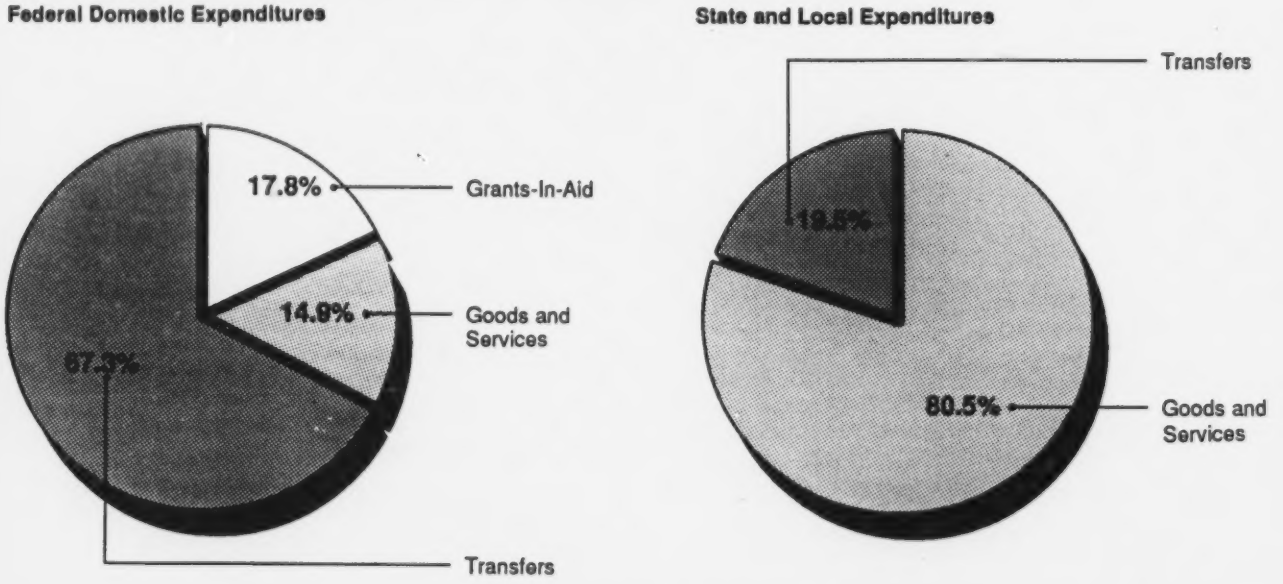
Note: State and local expenditures are expenditures financed from own sources, i.e., they exclude spending from federal grants-in-aid.

State-Local Governments Are the Primary Provider of Domestic Services

Domestic expenditures can be categorized into three groups: transfers of income from taxpayers to certain individuals, grants to other levels of governments, and purchases of goods and services. The federal government makes by far the largest part of its domestic expenditures—about two-thirds—on transfers, for example, through Social Security and Medicare. It spends slightly less than one-fifth of its funds on grants to state and local governments, including grants for Medicaid and AFDC transfers. The smallest part of federal expenditures is for the direct purchase of goods and services.

In contrast, state and local governments spend about four-fifths of their budgets (including grant funds) to purchase goods and services for the public, making them the primary provider of domestic services. State-local governments also spend a significant amount—about one-fifth—of their budgets on transfers, such as Medicaid and AFDC. (See fig. 2.3.)

Figure 2.3: Composition of Federal Domestic Expenditures and State-Local Expenditures (1990)



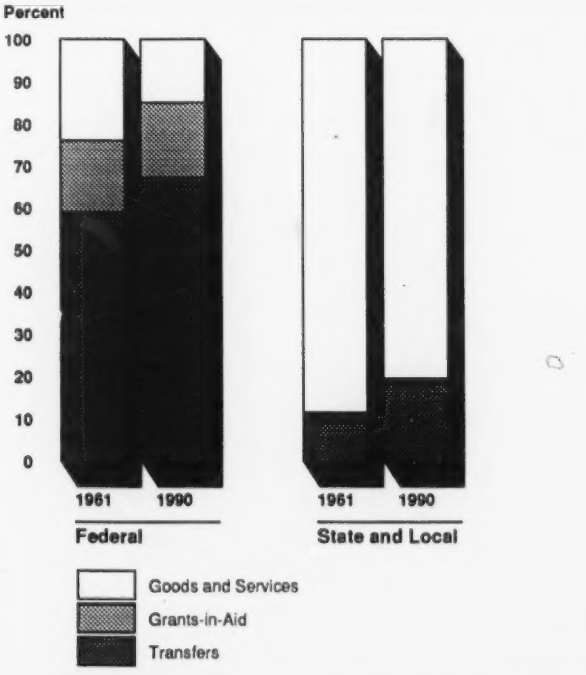
Note: State and local expenditures are current services expenditures, i.e., they exclude net interest payments. Federal expenditures exclude net interest payments as well as purchases of goods and services for national defense.

Transfer Payments Have Taken an Increased Share of Both Federal and State-Local Spending

Transfer payments increased from about 60 to 67 percent of federal domestic expenditures between 1961 and 1990. Over the same period, they nearly doubled as a portion of state and local current services expenditures, increasing from about 10 to 20 percent. (See fig. 2.4.)

Spending on goods and services has been squeezed at both the federal and state-local levels. Federal grants-in-aid made up about the same portion of federal domestic spending in 1990 as they did in 1961 (but grant levels varied significantly in the intervening years, as will be shown in sect. 4).

Figure 2.4: Composition of Federal Domestic Expenditures and State-Local Expenditures
(1961 and 1990)



Note: State and local expenditures are current services expenditures, i.e., they exclude net interest payments. Federal expenditures exclude net interest payments as well as purchases of goods and services for national defense.

State-Local Expenditures

This section provides detail on the composition and growth of state-local general expenditures. (General expenditures exclude expenditures for utilities, liquor stores, and employee-retirement or other insurance trust funds.) The section focuses on the functions for which general expenditures are made and the split between current and capital expenditures.

This section uses data compiled by the Governments Division, Bureau of the Census. Table 3.1 provides definitions for the classifications used in this section.

Table 3.1: Definitions of Key Terms

Term	Definition
State-local expenditures, by function	
Education services:	Comprises education and libraries.
Education	Includes elementary and secondary education (kindergarten through high school); higher education (degree-granting, post-secondary institutions operated by state and local governments); and other education (e.g., state educational administration and tuition, grants, and fellowships).
Social services and income maintenance:	Comprises public welfare, health, hospitals, social insurance administration, and veterans' services.
Public welfare	Includes cash assistance paid directly to needy persons under such programs as AFDC; vendor payments made directly to private purveyors for commodities and services provided under welfare programs (including payments for medical care made through Medicaid); and provision and operation by the government of welfare institutions, including nursing homes not directly associated with government hospitals.
Health and hospitals	Includes outpatient health services, other than hospital care, and general public health activities; financing, construction and acquisition, maintenance or operation of hospital facilities; provision of hospital care; and support of public or private hospitals.
Environment and housing	Comprises natural resources, parks and recreation, housing and community development, sewerage, and solid waste management.
Governmental administration	Comprises financial administration, judicial and legal, and general public buildings functions; and activities of the governing body, office of the chief executive, and central staff services and agencies.
Interest expenditure	Amounts paid for the use of borrowed money. Does not include interest on utility debt.
Public safety	Comprises police protection, fire protection, correction, and protective inspection and regulation.
Transportation	Comprises highways, air transportation, parking facilities, water transport and terminals, and transit subsidies.
State-local expenditures, by object classification	
Current expenditure	All expenditures with the exception of capital outlay.
Capital outlay	Direct expenditure for construction of buildings, roads, and other improvements; for purchases of equipment, land, and existing structures; and for payments on capital leases. The largest categories of capital outlay are highways, education, and sewerage.

Source: U.S. Department of Commerce, Bureau of the Census, Government Finances.

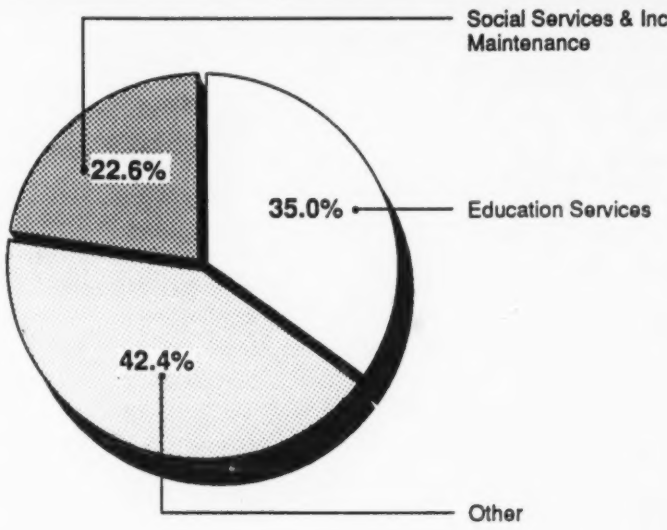
State and Local Governments Spend Mostly for Education Services and Social Services-Income Maintenance

The two largest categories of state-local general expenditures are (1) education services and (2) social services and income maintenance. Together these categories comprise well over half of total spending. (See fig. 3.1.)

Elementary and secondary education makes up the largest part of education services, accounting for nearly a quarter (24 percent) of total state-local spending. Health-related expenditures, including medical vendor payments (essentially, Medicaid) and other public health and hospital spending, make up about 70 percent of the social services and income maintenance category, or about 16 percent of total expenditures.

Public safety, transportation, and environment and housing each account for between 8 and 9 percent of total state-local spending. Administrative, interest, and miscellaneous expenses totaled 17 percent of spending in 1990.

Figure 3.1: Percent Distribution of State-Local General Expenditures (1990)



	Percent of Total
Education Services	**35.0**
Elementary and Secondary	24.2
Higher	8.9
Other	2.0
Social Services and Income Maintenance	**22.6**
Health and Hospitals	8.9
Medical Vendor Payments	6.9
Cash Assistance	2.7
Other	4.1
Other	**42.4**
Public Safety	8.9
Transportation	8.5
Environment and Housing	8.5
Interest Expense	6.0
Administration	5.4
Miscellaneous	5.3

Note: Detail may not add to totals due to rounding.

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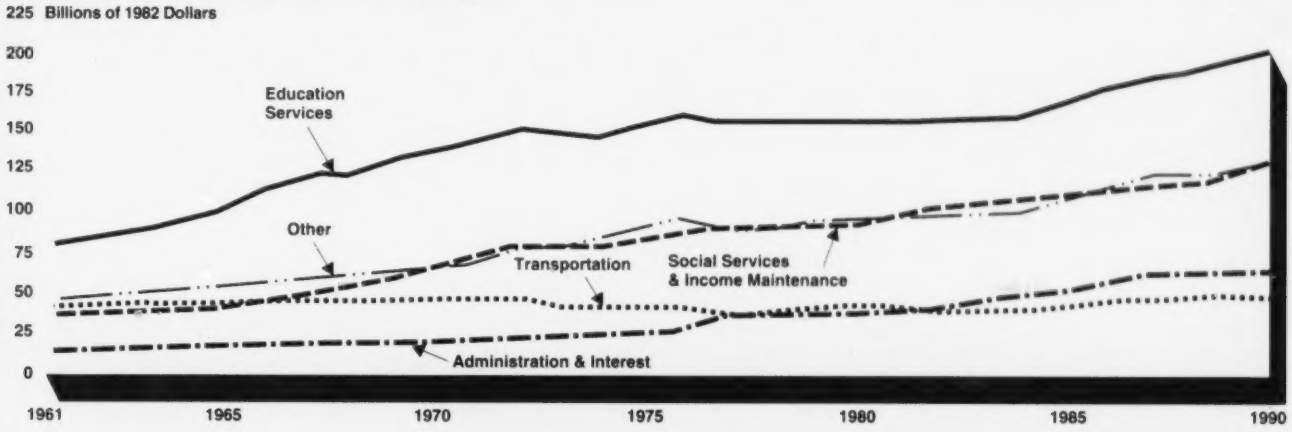
Real Growth Has Been Steady Except for Transportation and Education

All categories of spending, with the exception of transportation, have grown in real terms over the 30-year period. Transportation spending (predominantly highways) has been relatively flat throughout the entire period. (See fig. 3.2.) Total education spending stopped growing between 1976 and 1983, with growth in higher education spending offset by reductions at the elementary and secondary level. Since 1983, total spending has grown relatively rapidly, primarily at the elementary and secondary level. (See fig. 3.3.) Social services and income maintenance has grown at about the same rate as the other expenditure category since the 1970s. Essentially all the real growth in social services and income maintenance has been in the area of health—Medicaid's medical vendor payments (jointly financed with the federal government) and other public health and hospital expenditures. There has been virtually no real dollar growth in the cash assistance component over the entire period, except in the late 1960s and early 1970s.[1] (See fig. 3.4.)

Figure 3.2: State-Local Expenditures, by Function



Note: Administration is understated through 1976 because data on judicial and central staff activities are not available for those years. Other is understated through 1976 because data for certain of its elements are not available for those years.

[1]Real levels of cash assistance spending experienced an upturn in the late 1960s and early 1970s as participation rates in welfare programs increased. Between 1973 and 1975, state-local spending on cash assistance fell to its former level when Supplemental Security Income, a federal program providing assistance to the elderly, blind, and disabled, was enacted.

Figure 3.3: State-Local Education Expenditures

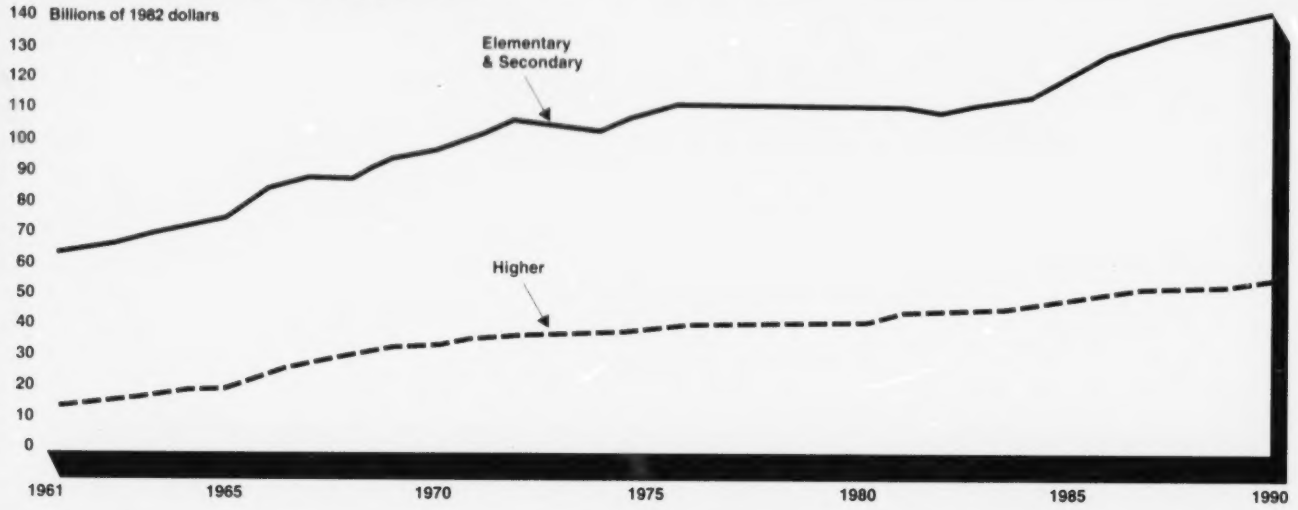
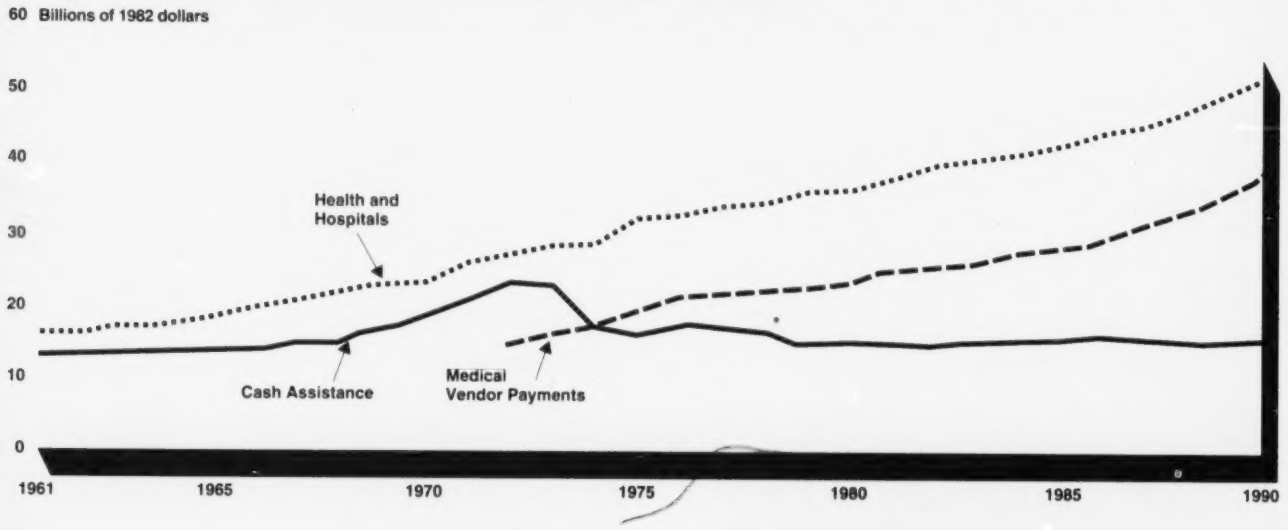


Figure 3.4: State-Local Social Services and Income Maintenance Expenditures



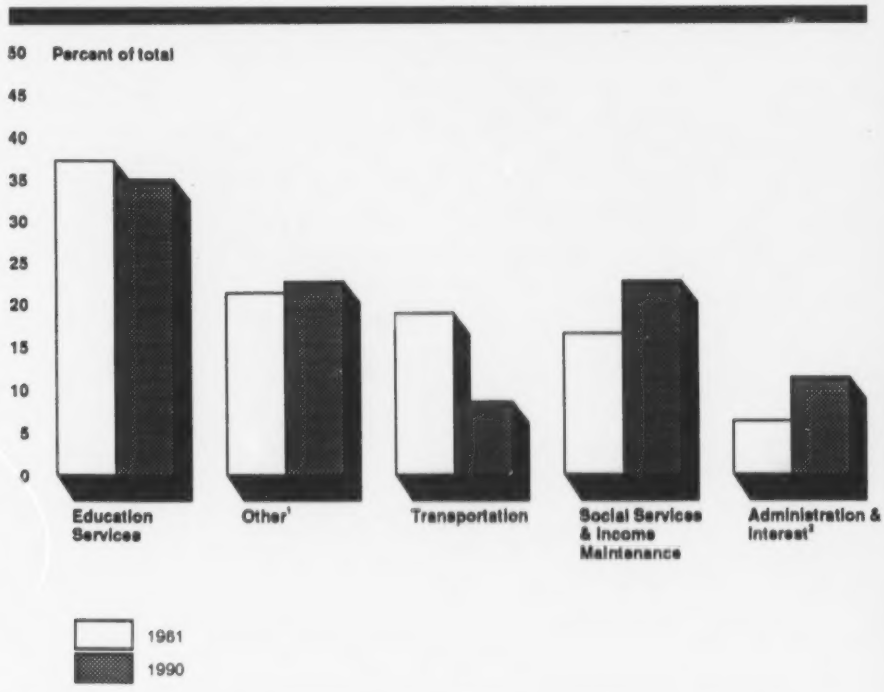
Note: Data on medical vendor payments are not available before 1972.

Education and Transportation Expenditure Shares Declined, Social Services Gained the Most

As a result of the growth patterns shown in figure 3.2, transportation's share of total state-local expenditures declined between 1961 and 1990 from 18.8 to 8.4 percent, while the share of spending for social services and income maintenance grew from 16.4 to 22.6 percent. Within social services and income maintenance, the portion of spending for medical vendor payments greatly increased, while the portion for cash assistance fell dramatically.

Between 1961 and 1990, education's total share also fell somewhat. Within education, the portion of expenditures for higher education increased, while that for elementary and secondary education decreased. (See figs. 3.5-7.)

Figure 3.5: Percent Distribution of State-Local Expenditures, by Function (1961 and 1990)



1. Includes public safety, environment and housing, and miscellaneous functions. Other is understated in 1961 because data for certain of its elements are not available for that year.

2. Administration is understated in 1961 because data on judicial and central staff activities are not available for that year.

Figure 3.6: Composition of State-Local Education Services Expenditures
(1961 and 1990)

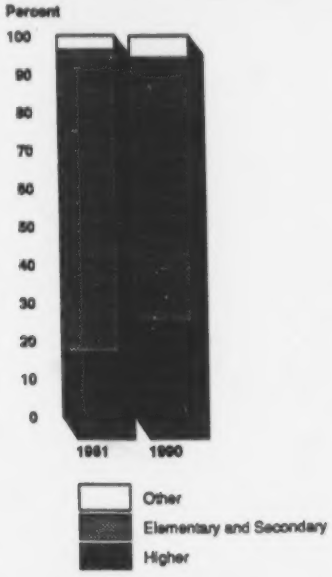
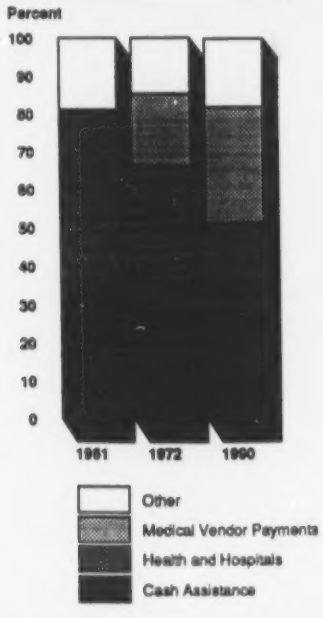


Figure 3.7: Composition of State-Local Social Services and Income Maintenance Expenditures
(1961, 1972, and 1990)



Note: Data on medical vendor payments are not available before 1972; for 1961, included in other.

Capital Has Shrunk as a Share of Spending and of the Gross National Product

Between 1961 and 1990, current spending drove the growth in state-local expenditures, while capital spending experienced little real growth. Thus, as a percentage of GNP, capital spending declined over the three decades, with most of this decline occurring in the 1970s. (See fig. 3.8.)

As a consequence of the divergent growth patterns of current and capital spending, capital fell from one-fourth to one-eighth of total state-local general spending over the 1961-1990 period. (See fig. 3.9.)

Figure 3.8: State-Local Expenditures, by Object

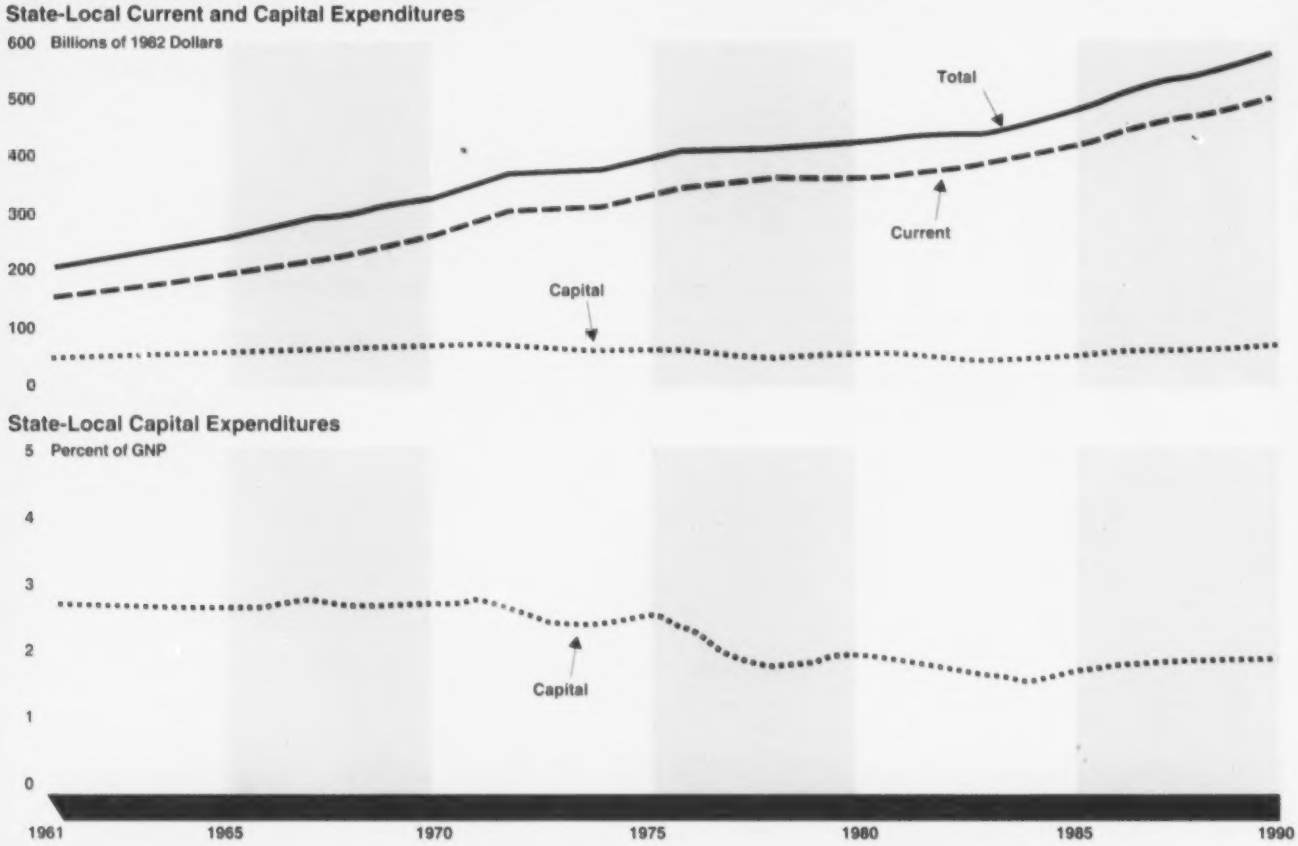
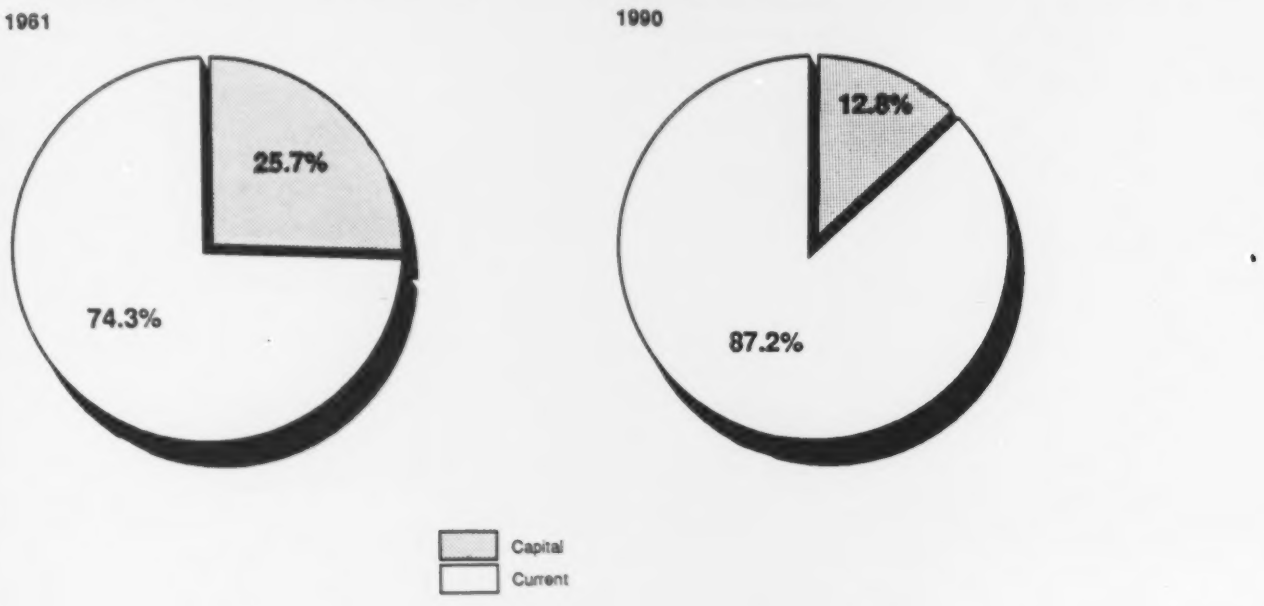


Figure 3.9: Percent Distribution of State-Local Expenditures, by Object (1961 and 1990)



State-Local Intergovernmental Revenues

State-local governments finance their expenditures with two sources of revenues: intergovernmental revenues from the federal government and revenues they raise from their own sources. This section looks at intergovernmental revenues; section 5 examines own-source revenues.

We use data from the Bureau of the Census and the Office of Management and Budget (OMB) in this section. From the Census Bureau, we use two data series: (1) state-local intergovernmental revenues received from the federal government (see fig. 4.1), and (2) intergovernmental expenditures made by the federal government directly to state and local governments (see fig. 4.7).[1] From OMB, we use data on federal grant outlays by purpose (see figs. 4.2 and 4.3) and by federal budget function (see figs. 4.4-6).[2] Although the several data series used in this section use different terms for intergovernmental revenues, they are conceptually equivalent. Therefore, we use the term "intergovernmental revenues" throughout this section to refer to amounts received by state and local governments from the federal government or granted by the federal government to state-local governments.

Table 4.1 defines, by data source, the key terms used in this section.

Table 4.1: Definitions of Key Terms

Term	Definition
Census terms	
Intergovernmental revenue from the federal government	Amounts received from the federal government as fiscal aid in the form of shared revenues and grants-in-aid; as reimbursements for performance of general government functions and specific services for the paying government (e.g., care of prisoners or contractual research); or as payments in lieu of taxes.
Intergovernmental expenditure by the federal government	Amounts paid directly from the federal government to state or local governments as fiscal aid in the form of shared revenues and grants-in-aid, as reimbursements for performance of general government activities and for specific services for the paying government, or as payments in lieu of taxes.
OMB terms, by function	
Community and regional development	Includes community development grants and related housing and urban development programs; disaster assistance and relief; and other rural, area, and regional development and economic development assistance programs (budget function 450).

(continued)

[1]The two data series from the Census Bureau differ slightly because of differences in the fiscal years of the federal government and state-local governments.

[2]When we use OMB data, we exclude the transition quarter between 1976 and 1977 reported in the Budget of the U.S. Government, which occurred as a result of the federal fiscal year changing from ending in June to ending in September.

Term	Definition
Education	All grant programs of the Department of Education, including compensatory education for the disadvantaged; rehabilitation services and handicapped research; and vocational and adult education (budget function 500).
Health	Grants for health resources and services, including preventive health and alcohol, drug abuse, and mental health services. Also includes food inspection and occupational safety grants. Largest component is grants to states for Medicaid (budget function 550).
Income security	Cash and in-kind assistance, including family support and related payments to individuals; public housing and housing subsidies and assistance; food and nutrition programs; and unemployment trust fund administrative expenses (budget function 600).
Training, employment, and social services	Major programs include the social services block grant, payments to states for foster care and adoption assistance, training and employment services, and unemployment insurance (budget function 500).
Transportation	Federal aid for highways, urban mass transportation, airports, and other modes of transportation (budget function 400).
All other	Comprises grant outlays under agriculture (budget function 350); commerce and housing credit (370); energy (270); international affairs (150); administration of justice (750); natural resources and environment, including Environmental Protection Agency construction grants (300); veterans benefits and services (700); and general government, including general revenue sharing (800).
OMB terms, by purpose	
Payments for individuals	Grants to state or local governments to finance cash or in-kind benefits that transfer income to individuals or families. The major grant in this category is Medicaid. Other grants in this category are for Aid to Families with Dependent Children, food and nutrition assistance, and housing assistance.
Capital investment	Grants to assist states and localities with construction and other physical capital activities, including rehabilitation and acquisition of major equipment, that yield a stream of services over a period of years. Major grants in this category are for highways. Grants for airports, mass transit, sewage treatment plant construction, community development, and other areas are also included in this category.
Remainder	All grants not included in either of the two categories above. These grants are primarily for education, training, employment, and social services.

Sources: U.S. Department of Commerce, Bureau of the Census, Government Finances, and OMB, Budget of the U.S. Government.

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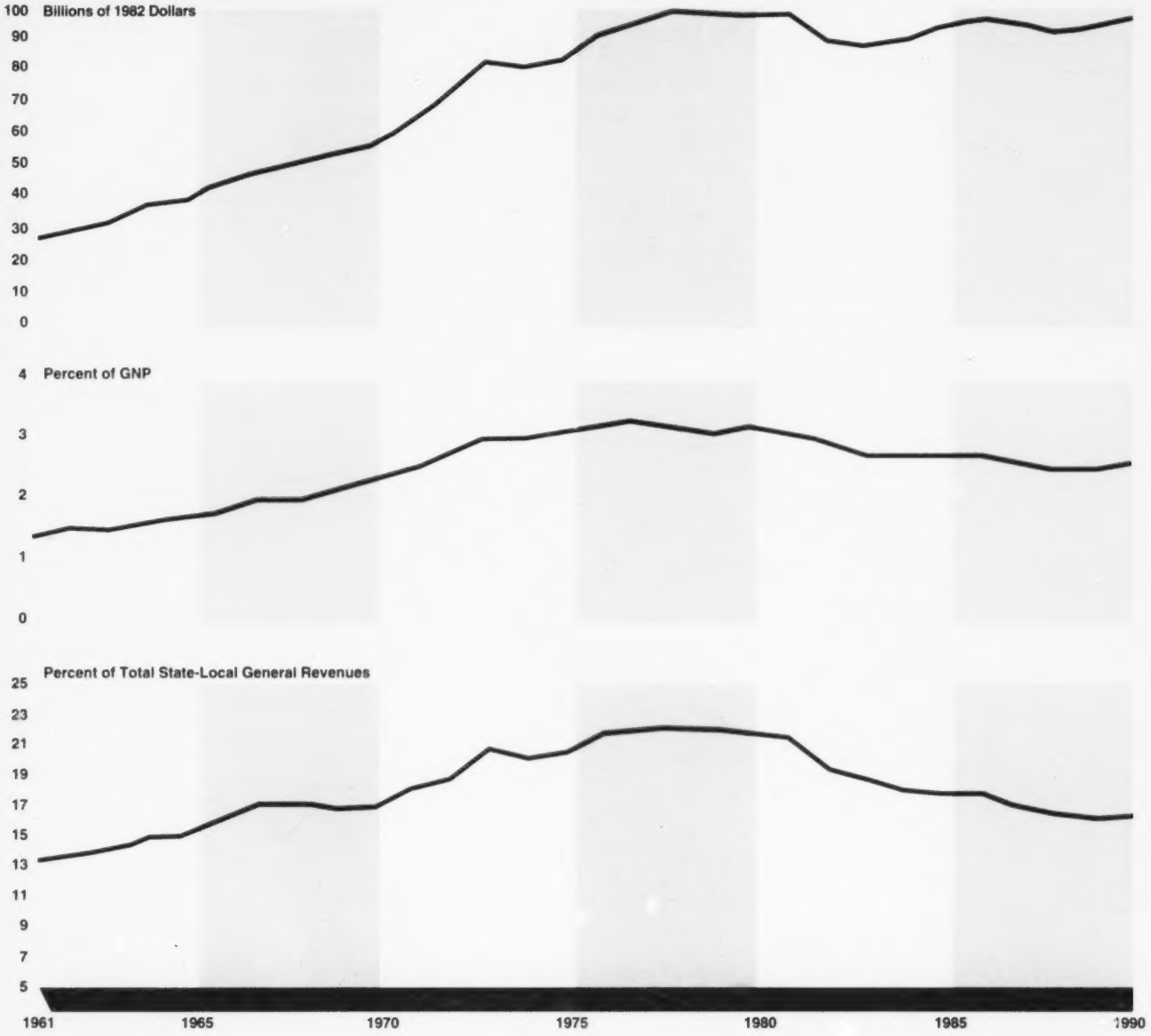
Intergovernmental Revenues Peaked in the Late 1970s

Real intergovernmental revenues rose consistently between 1961 and 1978, except for a small dip between 1973 and 1974. By 1990, they had nearly regained their 1978 peak level, after a sharp decrease between 1981 and 1982 and uneven growth thereafter.

Measured relative to the gross national product, however, intergovernmental revenues peaked between 1976 and 1978 at 3.1 percent and have since declined to 2.5 percent.

As a share of the total general revenues of state and local governments, intergovernmental revenues peaked in 1978 at 22 percent. Because intergovernmental revenues have not kept pace with the growth in state and local own-source revenues since the early 1980s, they now make up a significantly smaller share of total state-local revenues. Intergovernmental revenues as a share of total general revenues have declined sharply to 16 percent in 1990, about the same level as in 1966. (See fig. 4.1.)

Figure 4.1: State-Local Intergovernmental Revenues



Composition of Intergovernmental Revenues Has Shifted Toward Aid to Individuals, Away From Capital Investment

As the level of intergovernmental revenues has varied, their composition has also changed. This change has been particularly dramatic since the late 1970s, when total intergovernmental revenues leveled off and became a smaller part of total state-local revenues.

Intergovernmental revenues can be divided into the categories of payments for individuals, capital investment, and remaining revenues based on the purpose for which the federal government grants them. Viewed this way, intergovernmental revenues for individuals (largely Medicaid and AFDC) have grown the most, rising relatively consistently throughout the period. Capital investment revenues experienced some real growth in the first two decades, but have declined somewhat since 1980. Intergovernmental revenues for remaining purposes rose faster than the other two categories between 1961 and 1978, but have experienced a sharp decline since 1978. (See fig. 4.2.)

As a result of these growth trends, intergovernmental revenues for payments to individuals increased from slightly more than one-third of all such revenues in 1961 to well over one-half in 1990. Intergovernmental revenues for capital investment, on the other hand, have fallen from over two-fifths of all intergovernmental revenues in 1961 to under one-fifth in 1990. (See fig. 4.3.)

Figure 4.2: Intergovernmental Revenues, by Purpose

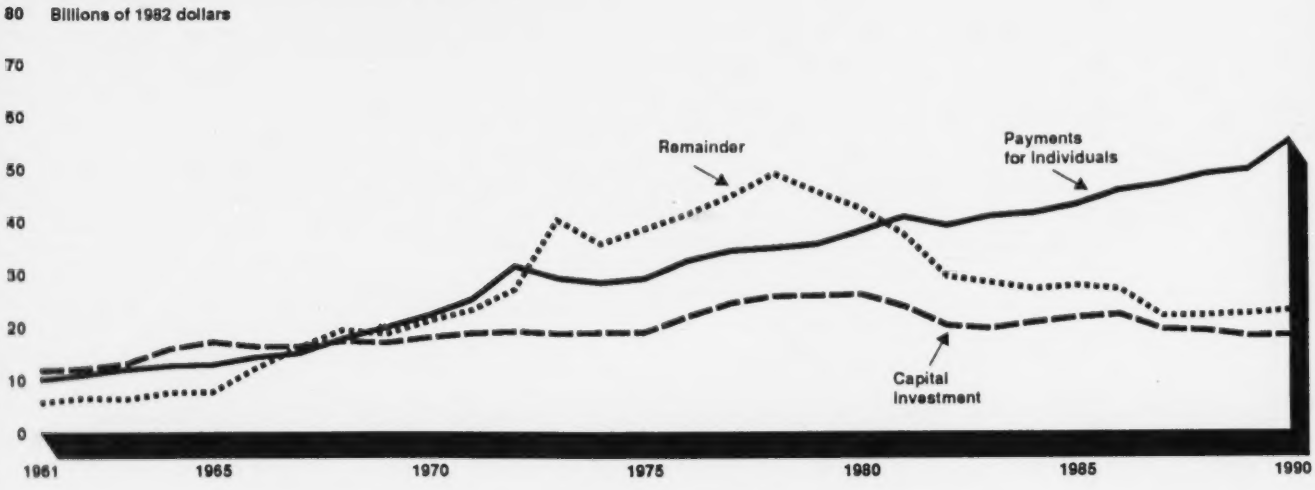
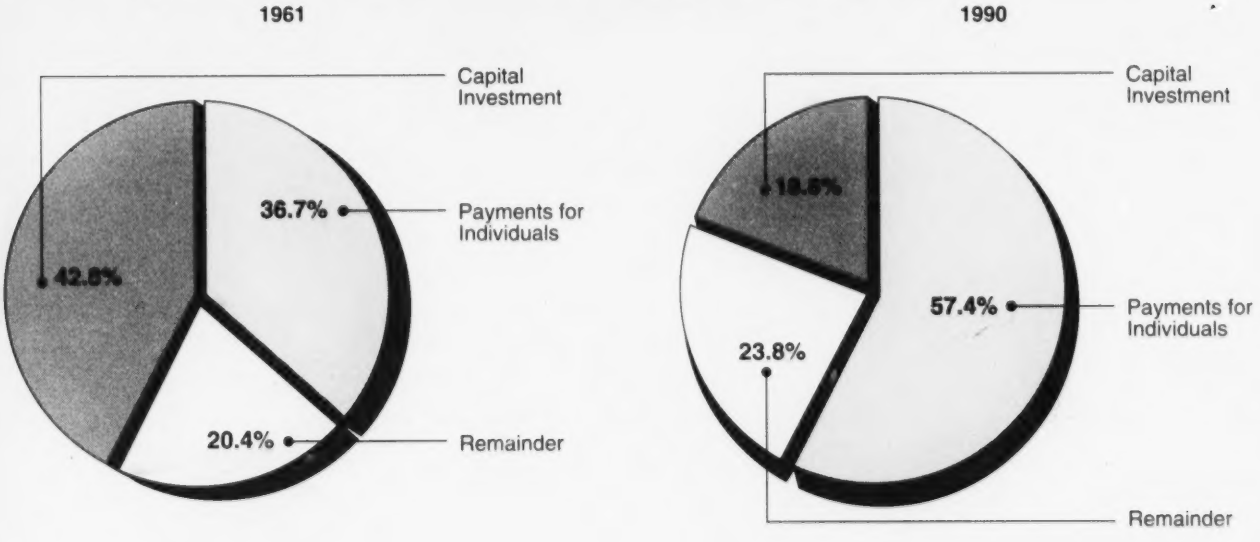


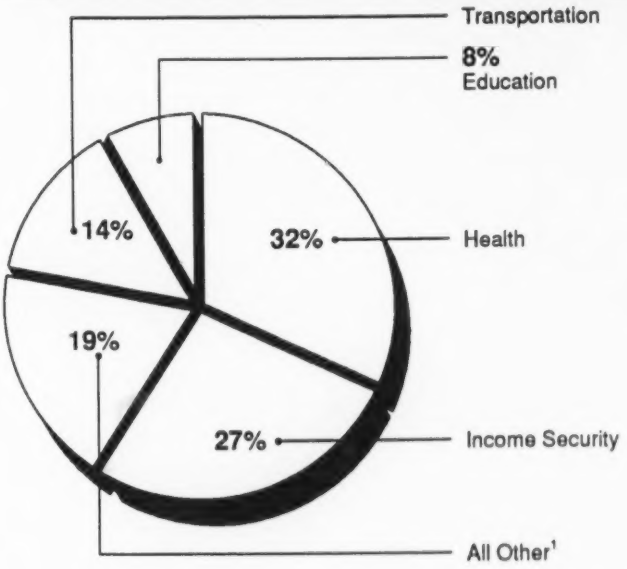
Figure 4.3: Percent Distribution of Intergovernmental Revenues, by Purpose (1961 and 1990)



Intergovernmental Revenues Are Mostly for Health and Income Security

In 1990, the largest part of intergovernmental revenues was for health and income security functions. These include intergovernmental revenues received by states for the major entitlement programs of Medicaid (health) and AFDC (income security). Intergovernmental revenues for transportation (primarily highways) and education also represented substantial, but significantly smaller, shares of total intergovernmental revenues. (See fig. 4.4.)

Figure 4.4: Percent Distribution of Intergovernmental Revenues, by Function (1990)



1. Includes agriculture, administration of justice, energy, general government, and several miscellaneous functions.

Intergovernmental Revenues Have Increased Relatively Consistently Only for Health and Income Security

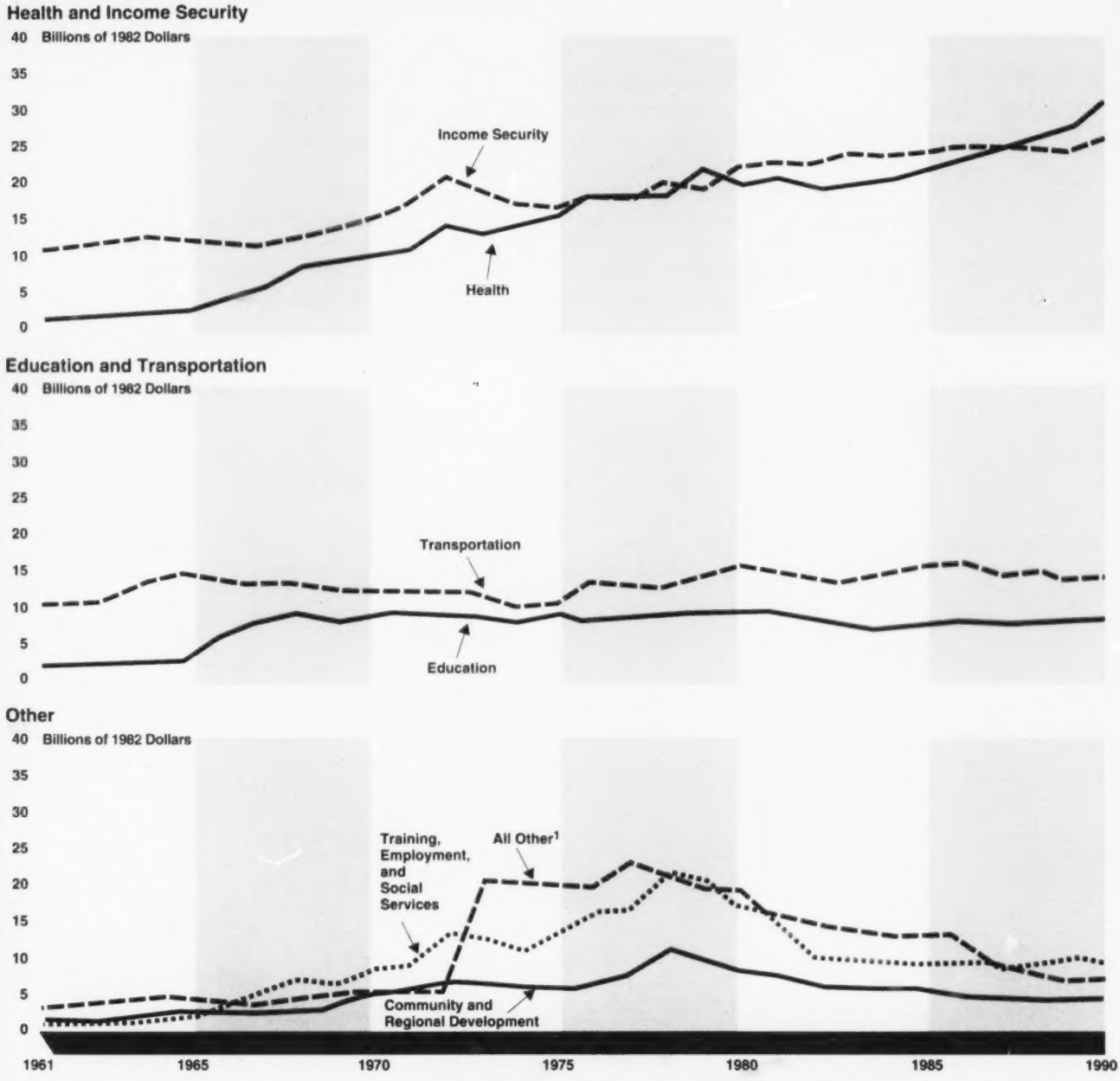
Intergovernmental revenues for health purposes, including the federal share of the Medicaid program,[3] have been the fastest growing category of intergovernmental revenues over the past three decades, especially in the late 1980s. Intergovernmental revenues for income security purposes, including AFDC, have also grown over the 30-year period, but not as fast as intergovernmental health revenues. Although intergovernmental revenues for income security were much higher in the 1960s than intergovernmental revenues for health, intergovernmental health revenues roughly equaled them in the late 1970s and surpassed them in 1987. Intergovernmental income security revenues have been virtually flat since the early 1980s.

Intergovernmental revenues for transportation have experienced some variation over the 30-year period, but have been relatively flat overall. Intergovernmental education revenues, after increasing rapidly in the late 1960s, have since declined slightly.

Other categories of intergovernmental revenues, including revenues for community and regional development and for training, employment, and social services, increased relatively consistently from the early 1960s through the late 1970s; they then decreased to levels prevailing in the early 1970s. The category of "other" intergovernmental revenues includes the general revenue sharing (GRS) program, and thus reflects the beginning of payments in 1973, the termination of payments to states in 1980, and the elimination of the program in 1986. (See fig. 4.5.)

[3]Medicaid is financed jointly by the federal government and the states through a matching formula. The relative federal and state shares of Medicaid financing have remained fairly stable since the late 1960s, with the federal government picking up slightly over half of the program's costs. Thus, the growth in intergovernmental revenues for Medicaid is matched by corresponding growth in state-local Medicaid expenditures.

Figure 4.5: Intergovernmental Revenues, by Function



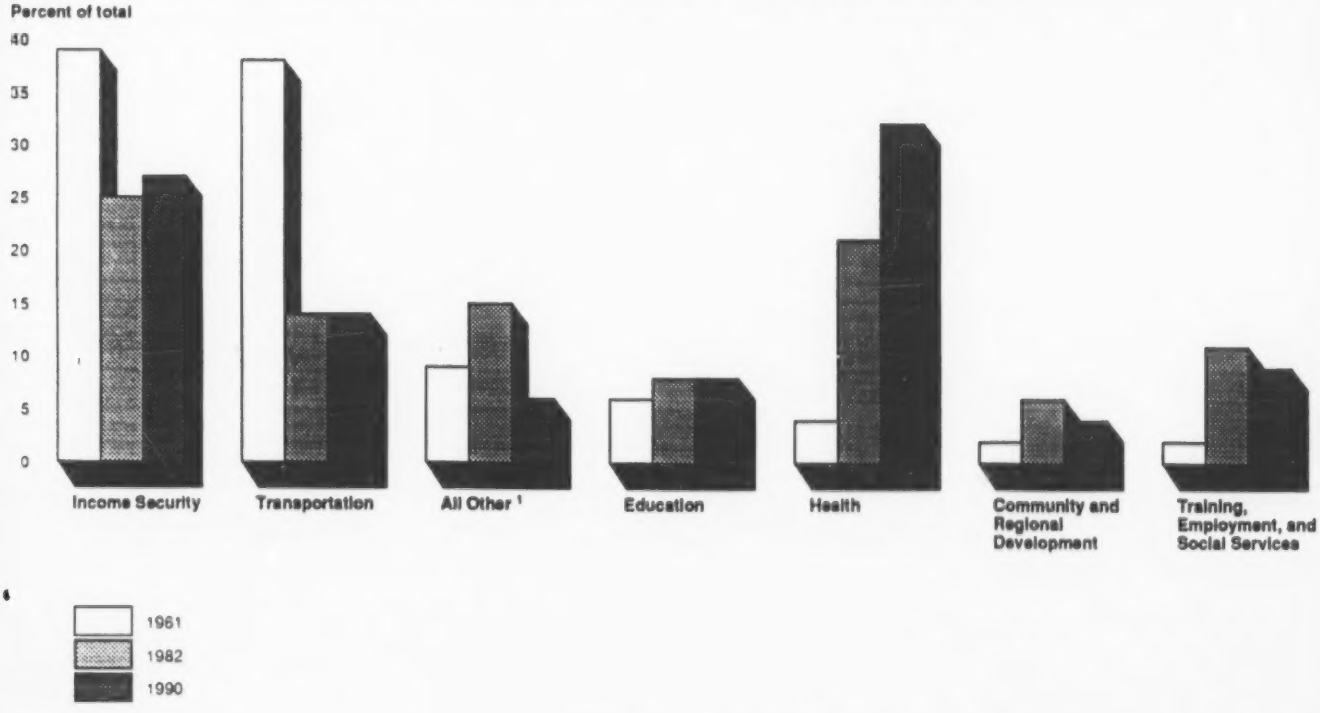
[1] Includes grants for agriculture, administration of justice, energy, general government (including GRS), and several miscellaneous functions.

Transportation and Income Security Intergovernmental Revenue Shares Declined, Health Gained the Most

Between 1961 and 1990, the composition of intergovernmental revenues changed significantly. Whereas in 1961, income security and transportation each comprised almost 40 percent of all intergovernmental revenues, by 1990 income security's share had fallen to 27 percent and transportation's to 14 percent. Intergovernmental health revenues experienced the most dramatic increase—from less than 5 percent of all intergovernmental revenues in 1961 to almost 35 percent in 1990, becoming the largest single category of intergovernmental revenues.

Training, employment, and social services; community and regional development; and education also experienced small gains in intergovernmental revenue shares between 1961 and 1990. However, between 1982 and 1990, community and regional development and training, employment, and social services lost shares. (See fig. 4.6.)

Figure 4.6: Percent Distribution of Intergovernmental Revenues, by Function (1961, 1982, and 1990)



1. Includes agriculture, administration of justice, energy, general government, and several miscellaneous functions.

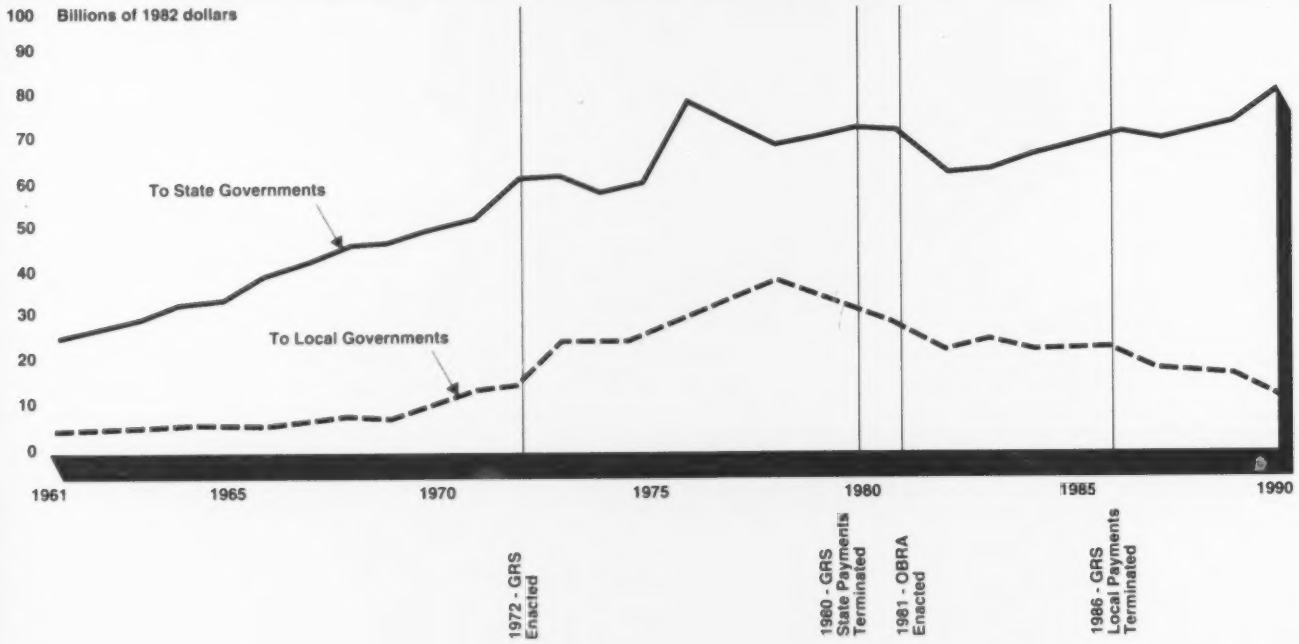
Intergovernmental Revenues to States Increased While Those to Local Governments Decreased in the 1980s

Intergovernmental revenues to both state and local governments grew from the early 1960s through the late 1970s, with the growth in direct federal-local revenues beginning to accelerate in the late 1960s. In the 1980s, state intergovernmental revenues were reduced by the Omnibus Budget Reconciliation Act of 1981 (OBRA) but resumed growing thereafter, whereas local intergovernmental revenues from the federal government continued a decline that began in the late 1970s. Thus, from 1983 on, intergovernmental revenues to states have grown while federal-local intergovernmental revenues have declined. (See fig. 4.7.)

Intergovernmental revenues to states and local governments have been shaped by policy as well as economic factors. Intergovernmental revenues to both state and local governments were increased with the advent of GRS payments in the early 1970s, then reduced when these payments were phased out. The peak period for local intergovernmental revenues from the early 1970s to early 1980s reflects the growth and decline of federal programs granting funds directly to communities for such purposes as urban renewal and local public works. Intergovernmental revenues to states have exhibited a cyclical pattern corresponding to economic recessions. State intergovernmental revenues for entitlement programs tend to increase in response to recession-driven demands and, in some cases, temporary anti-recession general assistance aid has been provided to them.

The diverging patterns of state and local intergovernmental revenues from the federal government since the early 1980s partly reflects the growth of entitlement programs, such as Medicaid and AFDC, for which intergovernmental revenues are granted directly to the states. In addition, OBRA increased state intergovernmental revenues at the expense of intergovernmental revenues going directly to local governments by eliminating many federal-local programs while creating several new state-administered block grants.

Figure 4.7: Intergovernmental Revenues to State Governments and Local Governments



State-Local Own-Source Revenues

This section deals with the majority of state-local revenues—own-source revenues. Own-source revenues (relative to a tax base measure, such as the gross national product) can be interpreted as the burden on taxpayers of supporting that government. In addition to examining the trends in the growth and functional composition of own-source revenues, this section compares the relative tax burdens of the federal, state, and local governments.

We use National Income and Product Accounts data on governmental receipts in figure 5.1 to compare federal and state-local tax burdens.[1] In the remainder of the section (figs. 5.2-9), we use Census data to examine in detail state-local own-source general revenues. (General revenues include all revenue of state and local governments except that of liquor stores, insurance trust funds, and utilities.)

Definitions of the relevant NIPA and Census classifications are provided in Table 5.1.

[1]NIPA receipts is a slightly broader measure of revenues than that used in the remainder of the section, but this data source allows comparison of federal and state-local tax burdens.

Table 5.1: Definitions of Key Terms

Term	Definition
NIPA terms	
Federal receipts	Includes personal tax and nontax receipts (e.g., income taxes); corporate profits taxes; indirect business taxes (e.g., excise taxes); and contributions for social insurance (Social Security, Medicare, unemployment insurance, federal employee retirement, railroad retirement, veterans' life insurance, and workers' compensation).
State and local own-source receipts	Total receipts, excluding federal grants-in-aid.
State and local social insurance contributions	Payments into state-local social insurance funds (state and local employee retirement, temporary disability, and workers' compensation funds).
Census terms	
Taxes:	Compulsory contributions exacted by a government for public purposes, except employee and employer assessments for retirement and social insurance purposes.
Property taxes	Taxes conditioned on ownership of property and measured by its value.
Sales taxes	Includes general sales or gross receipts taxes, which are applicable with only specified exceptions to all types of goods and services or all gross income; and selective sales and gross receipts taxes, which are imposed on sales of particular services or commodities (such as alcoholic beverages or tobacco products) or gross receipts of particular businesses, separately and apart from the application of general sales and gross receipts taxes.
Income taxes	Includes individual income taxes, which are taxes on individuals measured by net income and taxes distinctively imposed on special types of income (e.g., interest, dividends, income from intangibles) and corporation net income taxes, which are taxes on net income of corporations and unincorporated businesses (when taxed separately from individual income).
Charges	Amounts received from the public for performance of specific services which benefit the person charged, and from sales of commodities and services. Includes charges for general government purposes only (i.e., excludes utility charges and liquor store sales).
Interest earnings	Interest earned on deposits and securities. General revenue interest earnings do not include earnings on assets of employee-retirement systems.

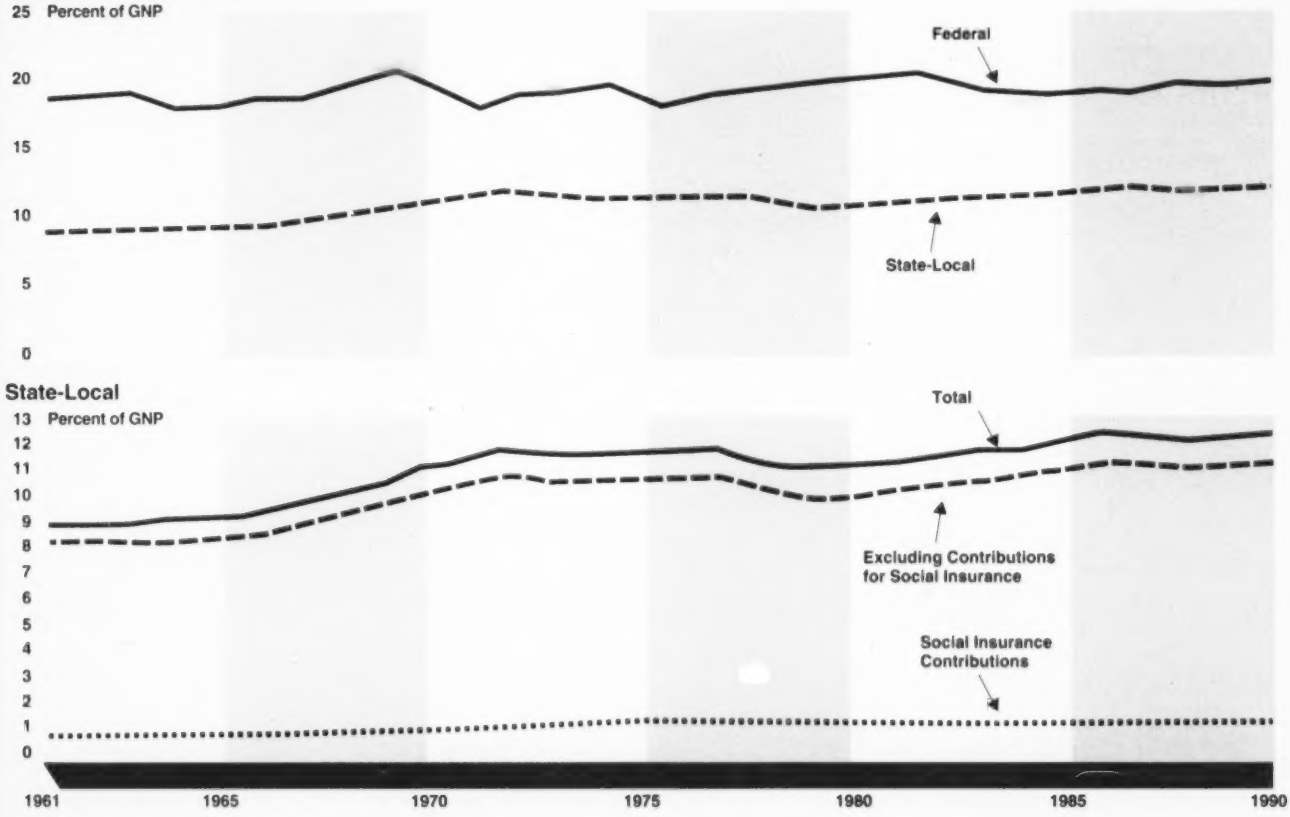
Sources: U.S. Department of Commerce, Bureau of Economic Analysis, NIPA, and Bureau of the Census, Government Finances.

State-Local Tax Burdens at an All-Time High

Total federal receipts (for domestic as well as all other purposes) have represented a considerably larger share of the economy than total state-local receipts over the past three decades. Total federal tax burdens (receipts as a percentage of GNP) rose from 18.5 percent in 1961 to 20.3 percent in 1990—about a 10 percent increase. Federal tax burdens declined in the early 1980s before leveling off.

In contrast, total state-local tax burdens have risen almost 40 percent between 1961 and 1990—own-source receipts have gone from 8.8 percent of the GNP to 12.2 percent. Most of this growth occurred in two periods: the late 1960s-early 1970s and first half of the 1980s (while federal burdens were declining). As social insurance contributions have been virtually flat over the entire period, most of this increase has been to support general state-local expenditures. (See fig. 5.1.)

Figure 5.1: Own-Source Receipts



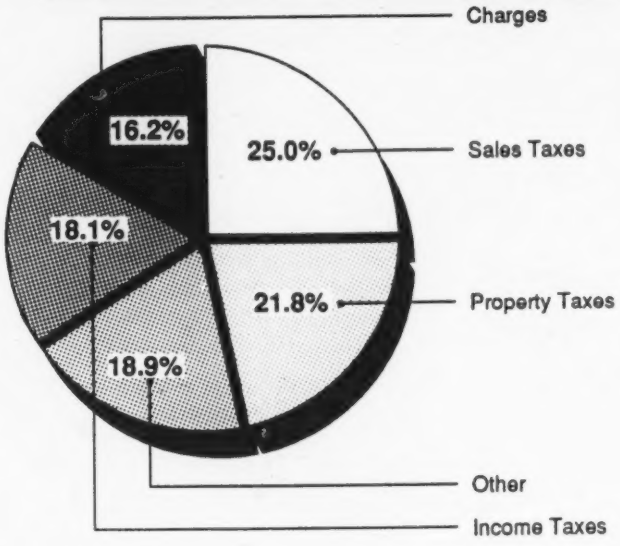
Sales, Property, and Income Taxes and User Charges Are the Major Own-Source Revenues

State and local governments raise their own revenues primarily through property, sales, and income taxes, along with user charges and miscellaneous other sources.

Sales taxes, the largest type of own-source revenues, include both general and selective taxes. General taxes account for about two-thirds of all sales taxes. Income taxes include taxes on both individuals and corporations; individual income taxes comprise over 80 percent of such taxes.

Miscellaneous tax and nontax revenues together account for 11 percent of general revenues; interest earnings on deposits and securities make up the remaining 8 percent. (See fig. 5.2.)

Figure 5.2: Percent Distribution of State-Local Own-Source Revenues (1990)



	Percent of Total
Sales Taxes	**25.0**
General	17.0
Selective	7.9
Property Taxes	**21.8**
Income Taxes	**18.1**
Individual	14.8
Corporate	3.3
Charges	**16.2**
Other	**18.9**
Interest Earnings	8.2
Miscellaneous Taxes	5.5
Miscellaneous Non-Tax Revenues	5.2

Note: Detail may not add to totals due to rounding.

Growth in Major Own-Source Revenues Fairly Steady Except for Property Taxes

With the exception of the property tax, the major own-source revenues of state and local governments have grown fairly steadily over the last 30 years. All of the revenue sources experienced less rapid growth in the mid-1970s and early 1980s than in the earlier and later periods. Income and sales taxes, particularly taxes on individual income and general sales, grew somewhat faster overall than the other major sources. In contrast, taxes on selective sales and corporate income grew somewhat more slowly. (See figs. 5.3-5.)

The growth of real property tax revenues was halted in 1972 and continued a general decline through 1980 due to taxpayer revolts, such as Proposition 13 in California. Since 1980, however, property taxes have resumed their upward trend. Because of the decline in property tax revenues, sales taxes overtook property taxes in 1978 as the largest source of state-local revenue.

Figure 5.3: Major State-Local Own-Source Revenues

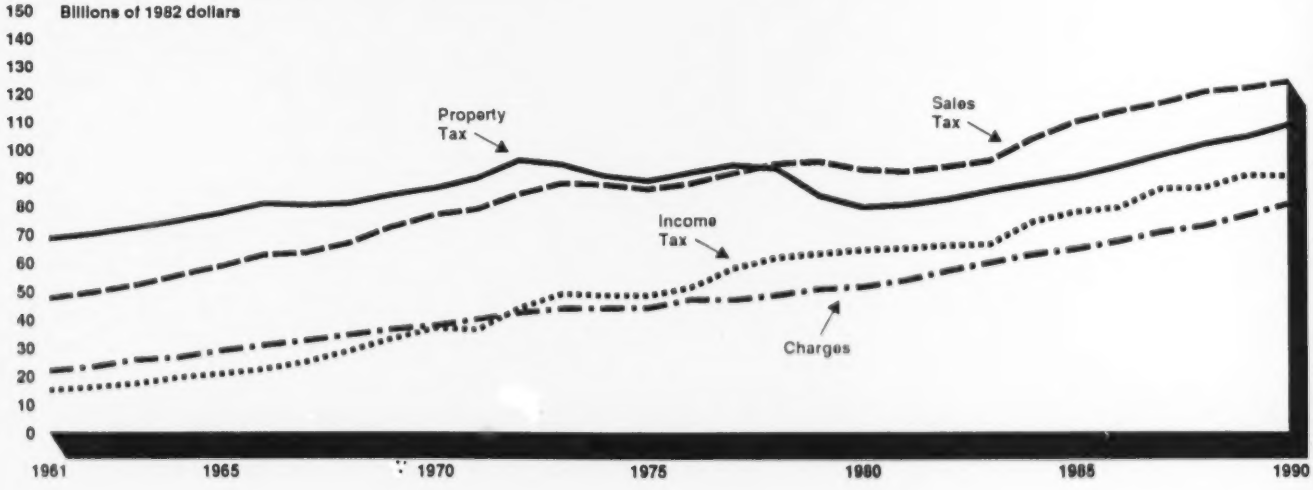


Figure 5.4: State-Local Sales Tax Revenues

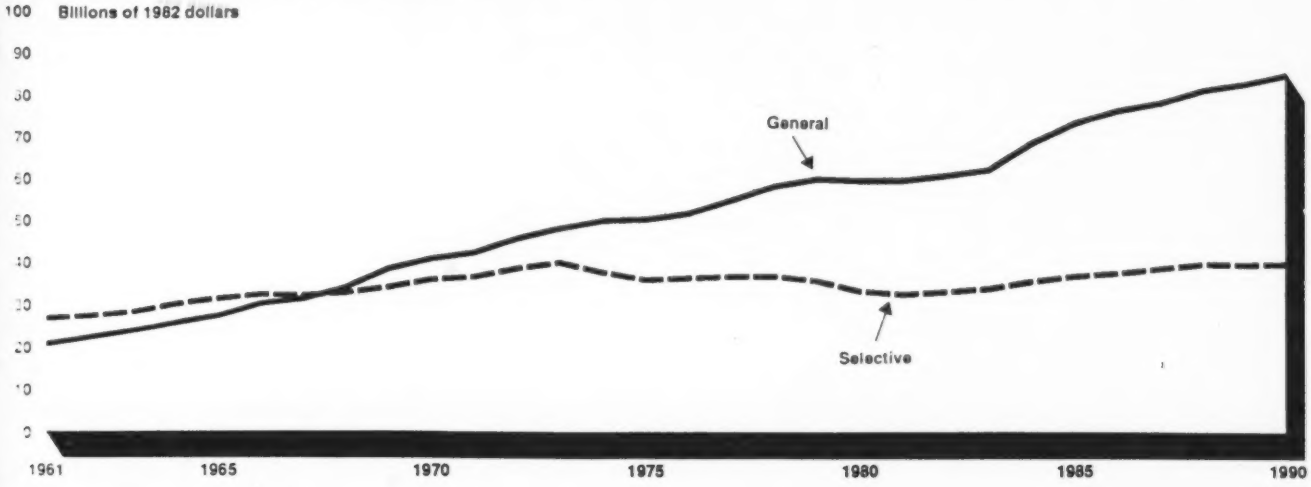
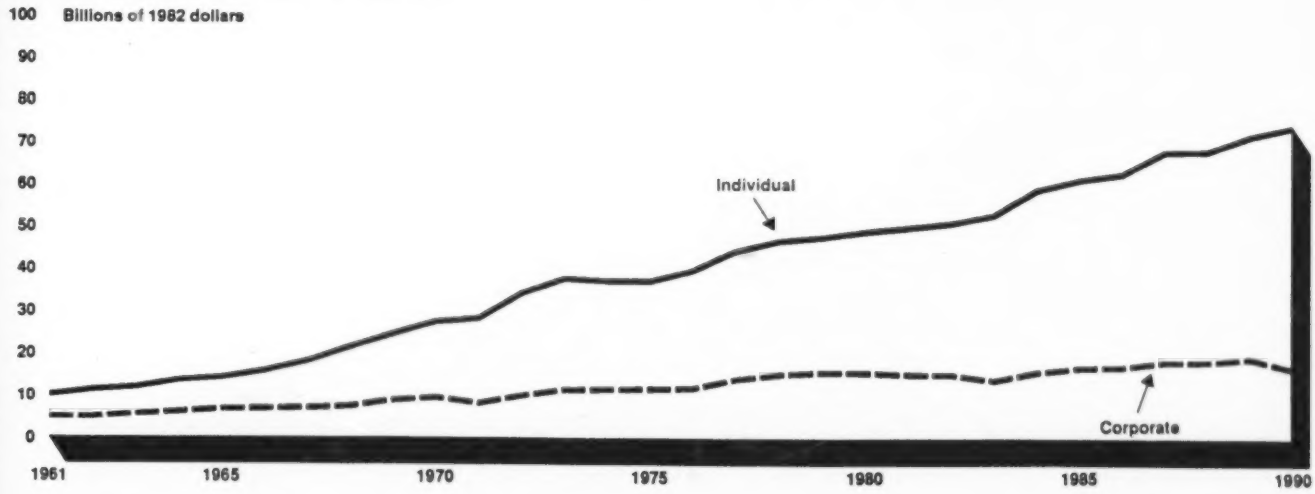


Figure 5.5: State-Local Income Tax Revenues



Property Taxes Declined as a Share of Revenues, Income Taxes Gained

As a result of the growth patterns in the various own-source revenues, particularly the decline in property tax revenues from 1972 to 1980, the share of property taxes in total own-source revenues decreased substantially between 1961 and 1990—from nearly 40 percent to slightly more than 20 percent. The share of total sales taxes in own-source revenues also declined, although only slightly, between 1961 and 1990. However, the composition of sales taxes shifted toward general sales taxes. (See figs. 5.6 and 5.7.)

Over the same period, the share of income taxes increased significantly. This increase was due primarily to growth in individual, rather than corporate, income taxes, as shown in figure 5.8. Other revenues also gaining shares were user charges and interest earnings.

Figure 5.6: State-Local Own-Source Revenues (1961 and 1990)

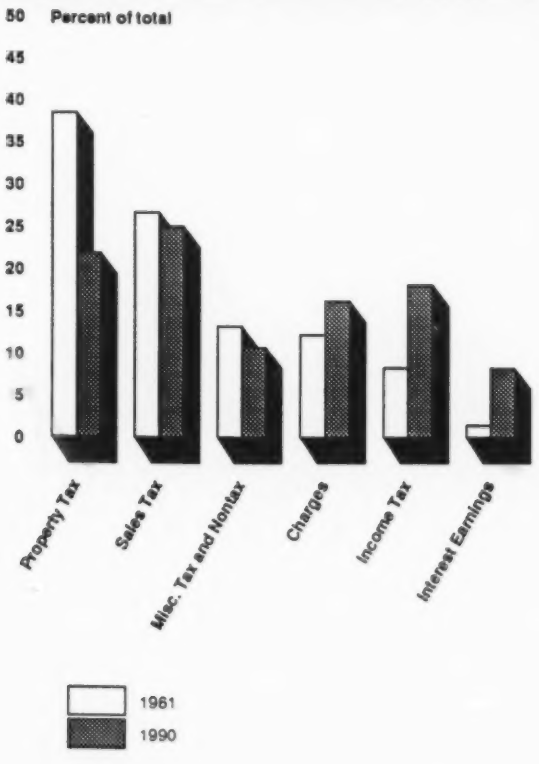


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Figure 5.7: Composition of State-Local Sales Tax Revenues (1961 and 1990)

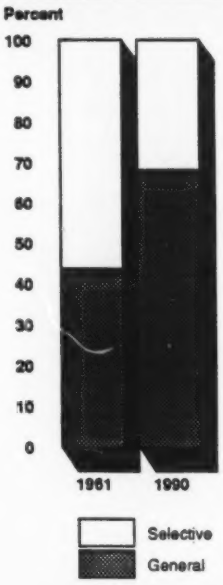
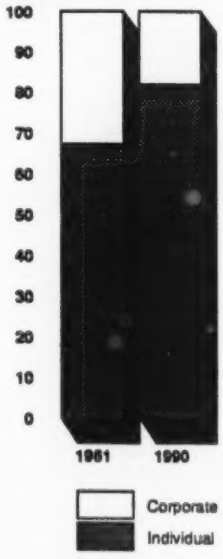


Figure 5.8: Composition of State-Local Income Tax Revenues (1961 and 1990)

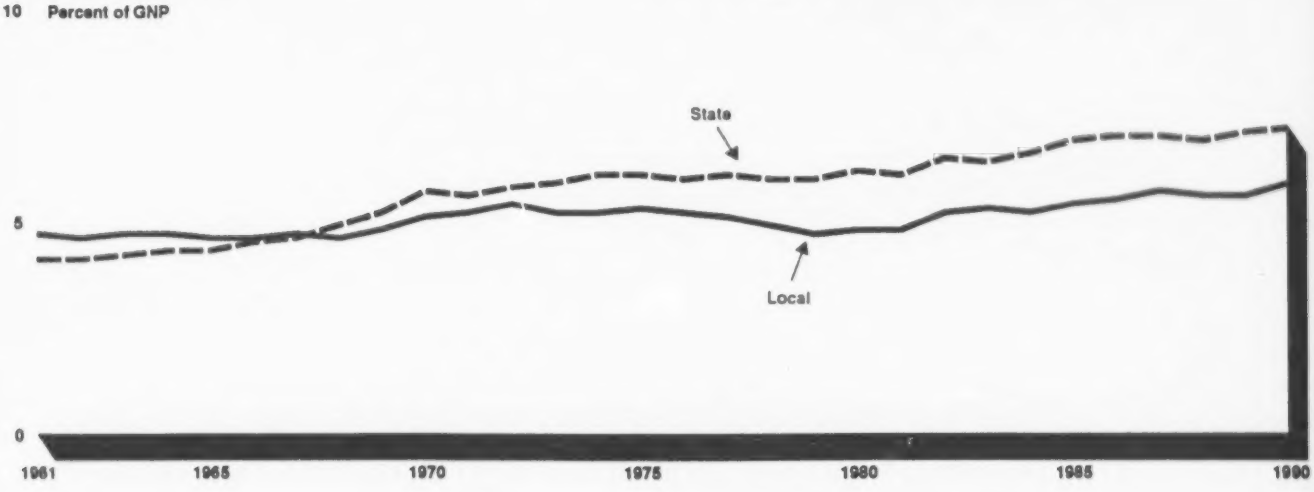


Financing Has Shifted From the Local to State Level

Before 1968, local governments financed a larger share of state-local government than did state governments. Between 1968 and 1978, however, states assumed an increasing part of the burden. This shift reflects the decline in property tax revenues, which continues to be the mainstay of local government tax revenues.[2]

Since 1978, tax burdens (revenues expressed as a percent of GNP) at the state and local levels have grown at approximately the same rate. State government tax burdens have exceeded tax burdens at the local level by about 1 to 1.5 percent of GNP. (See fig. 5.9.)

Figure 5.9: Own-Source Revenues



[2]Property taxes made up about 87 percent of all local tax revenues in the early 1960s. Although their share of total local taxes has decreased, in 1990 they still made up 74 percent of such revenues.

Recent Experience of State-Local Finances

Available data for 1991 and 1992 show state and local government fiscal conditions continuing to deteriorate. The recession has increased fiscal pressures as revenue growth slowed and expenditure demands, especially for human and social services, continue to increase. State and local governments, which are generally required to have some form of a balanced budget, are struggling to bring revenues and expenditures into alignment by raising taxes or other revenues, reducing expenditures, and drawing down fund balances. These conditions are affecting states, cities, and counties alike.

This section updates the trends in the previous sections of this fact sheet with data reported by national associations of state and local governments. The data are collected through surveys conducted by these organizations and have not been verified by us.

Tax Increases

Over half the states enacted tax changes in fiscal year 1991 intended to result in net revenue increases, according to surveys conducted by the National Association of State Budget Officers and National Conference of State Legislatures. After increasing taxes 1.3 percent in 1989, states increased them an additional 3 percent in 1990 and another 5 percent in 1991.

At the local level, the National League of Cities reported that 85 percent of all cities it surveyed in April and May of 1991 raised or imposed new taxes or fees in the preceding 12 months. The National Association of Counties reported that about 40 percent of counties it surveyed raised revenues during their 1991 fiscal years.

Budget Cuts

Since 1990, state general fund budgets have not grown, after adjusting for inflation. Spending on Medicaid and corrections (predominantly prisons) continues to grow rapidly, while cash assistance, transportation, and higher education are experiencing the smallest nominal increases and actual negative budget changes in some states. An increasing number of states are finding it necessary to make mid-year budget cuts in order to balance their budgets—12 states made such cuts in 1989, increasing to 20 in 1990 and to 29 in 1991.

Local spending cuts have also been reported. In 1991, 59 percent of cities reported reducing their growth in operating spending, and 43 percent reported cuts in capital spending. About three-quarters of counties

reduced services and/or employees. In large counties, the areas most often slated for 1992 spending reductions are discretionary health and other social services. Postponing capital projects has also been a common practice in counties recently.

Fund Balances

State and local governments are also drawing down available reserves, indicating a weakened fiscal condition. The National Association of State Budget Officers reports that aggregate state fund balances fell $5.1 billion during 1991 to their lowest level (when compared to expenditures) since 1983. Furthermore, in 1990, 23 states reported a fund balance of 5 percent or more, while 9 had balances of less than 1 percent; by 1992 these figures had just about reversed—20 expected to have fund balances of less than 1 percent and 1 in 5 predicted balances of 5 percent or more.

Municipal and county fund balances have also been depleted. For example, 59 percent of cities expected to draw down their fund balances in 1991. In addition, 39 percent of the nation's most populous counties and 34 percent of counties under 100,000 population experienced a budget shortfall in fiscal year 1991, thus reducing available local balances.

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